Research
Economy Watch

23 August 2024

Retail Retreat Near Its End?

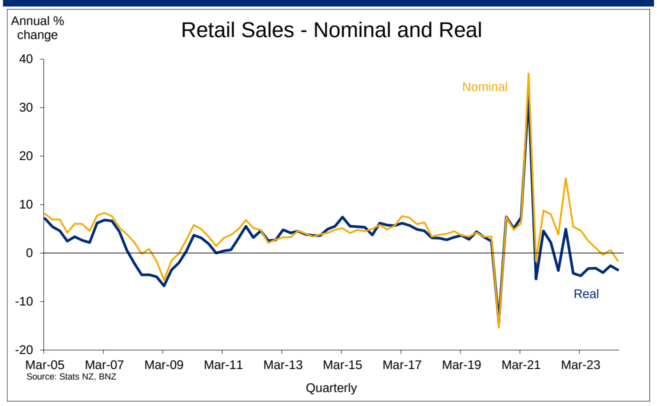
- **Retail sales volumes drop again**
- **Real sales per capita now down 13.7% from peak**
- **Profitability pressure intense and widespread**
- **Deteriorating labour market to remain a drag**
- **Lower interest rates, tax relief, terms of trade bounce to help lessen the gloom in time**

Today's retail sales figures essentially confirmed our suspicions – that sales are very weak and continued to decline in Q2. We thought when sales volumes bounced a touch in Q1 that it was more noise than any indication of change in trend at the time. Sales volumes fell 1.2% in Q2, taking sales 3.5% below on a year ago, and completing the third successive annual decline. Core (ex auto) sales volumes fell 1.0%.

The Q2 total sales decline was not that far from market (-0.9%) or our (-1.0%) expectations. But confirmation of a sizeable decline reinforces a host of weaker demand indicators through Q2.

As one of the early major partial indicators that feed into GDP it supports our (and the RBNZ's) view that the economy contracted in the second quarter. It also supports the recent RBNZ decision to start reducing interest rates and adds to the case for further OCR cuts.

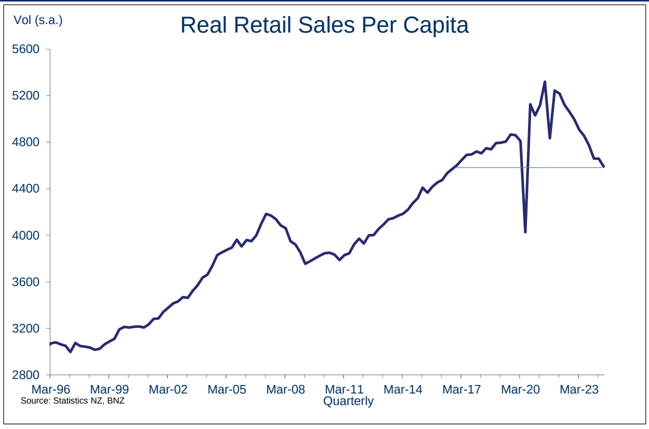
Sales behind year earlier levels



The value of retail sales in Q2 was 1.6% lower than in the same quarter a year ago. It is very unusual to see an annual decline in the dollar value of total retail sales. Outside of lockdowns, it has not occurred since the GFC back in 2008/09. However, the current situation appears even more challenging for retailers than that period.

Adjusting sales for inflation and population growth shows sales volumes per capita contracting for 10 consecutive quarters. This measure is now down a staggering 12.5% over that period and an even larger 13.7% from its peak three years ago. That is already a larger peak-to-trough decline than the 10.3% recorded during the GFC.

Bigger decline than during the GFC

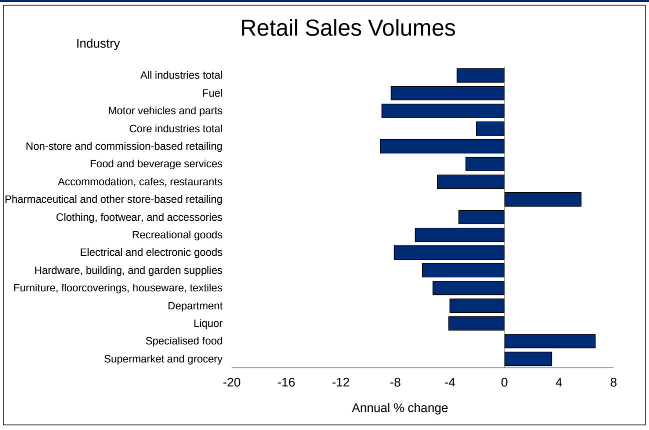


Given things like a deteriorating labour market, high interest rates, a subdued housing market, flat tourism, rapidly slowing net migration, and prior material weakness in the terms of trade – it is not at all surprising to see widespread declines in sales volumes.

Material price inflation over recent years in areas that are difficult to avoid like insurance, rent, and local authority rates along with higher debt servicing costs tends to leave less disposable income to spend elsewhere, including at retail outlets. Households have been facing very stiff headwinds for some time, as reflected in persistently very low consumer confidence.

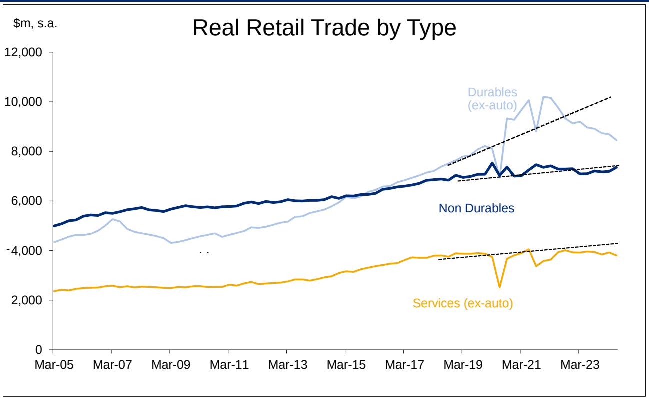
Across the major storetypes, only supermarkets, specialised food, and the pharmaceutical and other store-based retail category saw higher sales volumes compared to a year ago.

Widespread retreat



On a broader categorisation and look at the trends, spending on durables goods remains under the most downwards pressure. Services has edged lower, while spending on non-durable goods remains in touch with pre-covid trends.

Durable spending has suffered the most



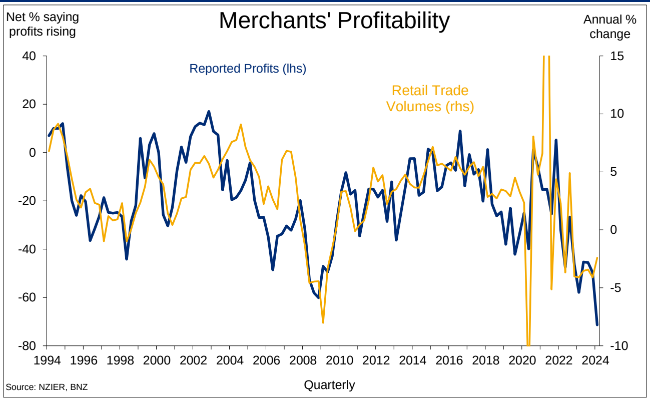
It all fits with households choosing the essentials first. And even on the essentials, there is anecdote of trading down or having 'less items in the basket' – something that fits will a lower value per electronic transaction.

In addition to falling sales – both in volume and value – retailers have also been facing higher costs. Recent data show a 16% increase in costs since pre covid. That doesn't include wages or interest costs, which have also increased. Again, it is no wonder that merchants continue to report extreme pressure on profitability – in the likes of the latest QSBO.

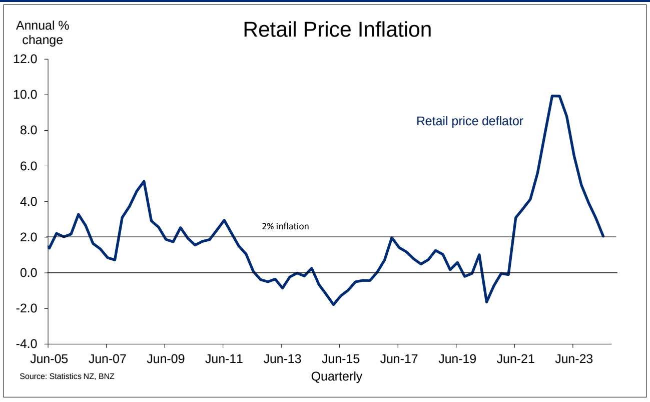
If there is any good news in any of this, it is that today's data confirms inflation continues to cool. This supports the RBNZ's recent decision to lower the OCR and adds to case for further reductions ahead. The retail trade implicit price deflator shows annual inflation has eased to 2.1%.

It is a sign that at least some of the recent headwinds facing the household sector are easing. The associated reduction in interest rates and the prospect of further reductions ahead is likely to add more to confidence and support more spending over time. Likewise, the recent implementation of some government policies like the personal income tax threshold adjustments and early childhood education subsidies. And Fonterra's announcement this morning that it has lifted its milk price forecast for its farmers supports our view that the terms of trade is rebounding firmly off its lows of last year, a plus for the country's purchasing power.

Profitability reports worse than GFC



No obstacle to further rate cuts



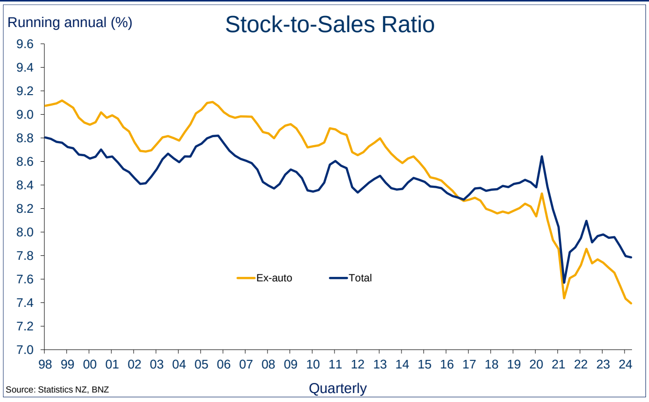
These positives may help bring some growth in retail sales volumes over the coming year. But even if the retreat is close to an end, we only see some stabilisation at first. We have pencilled in a flat result for Q3. And even if some growth occurs over the coming 12 months it needs to be seen in the context of coming off a much lower base as has been established by today's weak figures for Q2. A deteriorating labour market is expected to remain a headwind well into next year.

Finally, some observations around stocks and also on sales by region. A period of destocking looks to be continuing, judging by the value of retail stocks falling by 2.1% in the year ended June. The stocks-to-sales ratio remains below recent peaks, well below pre-covid levels, and the lowest in at least 26 years for core retail. We have seen similar destocking dynamics elsewhere through the supply chain. From a wider economy perspective, this is worth thinking about when demand improves, as it has the potential to generate an outsized pick up in production (or imports) if there was to be a period of restocking.

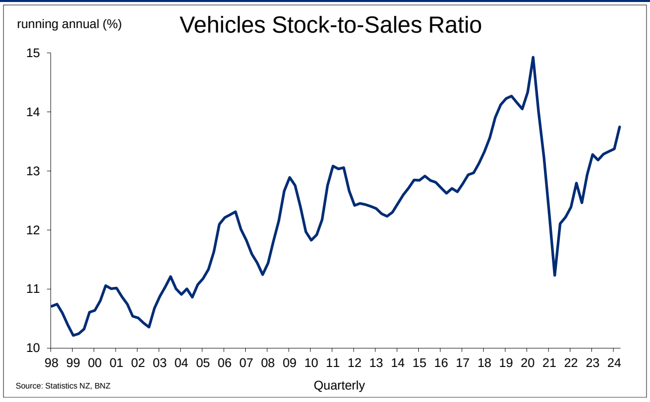
Interestingly, for vehicle retailers the recent dynamic appears to have been the opposite. Here there was further increase in the stocks-to-sales ratio in Q2. This fits with downward pressure on prices, with the retail price deflator for vehicles posting its third consecutive quarterly decline. Despite lower prices, vehicle sales volumes fell 2.7% in Q2.

Regards retail sales by region, major North Island areas have seen the dollar value of sales contract over the past year while mayor South Island areas have seen growth, albeit minimal. Retail sales in the North Island were 2.1% lower than a year ago, while in the South Island sales were up 0.6%.

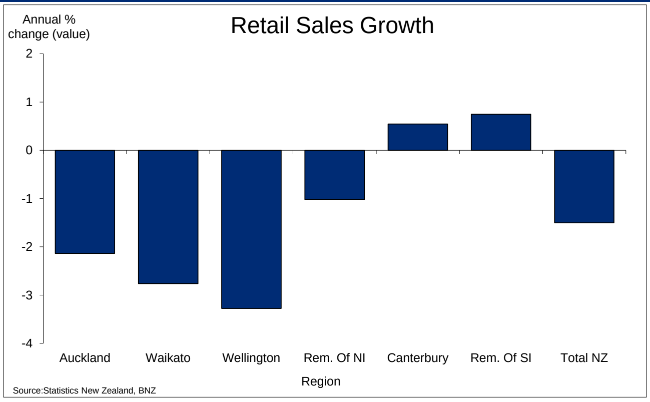
Destocking



Some elevation here



South on top



doug_steel@bnz.co.nz

Contact Details

BNZ Research

Stephen Toplis
Head of Research

Doug Steel
Senior Economist

Jason Wong
Senior Markets Strategist

Stuart Ritson
Senior Interest Rate Strategist

Mike Jones
BNZ Chief Economist

Main Offices

Wellington
Level 2, BNZ Place
1 Whitmore St
Private Bag 39806
Wellington Mail Centre
Lower Hutt 5045
New Zealand
Toll Free: 0800 283 269

Auckland
80 Queen Street
Private Bag 92208
Auckland 1142
New Zealand
Toll Free: 0800 283 269

Christchurch
111 Cashel Street
Christchurch 8011
New Zealand
Toll Free: 0800 854 854